7-15-2009

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LADB Staff

LADB Article Id: 50800
ISSN: 1054-8890

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by LADB Staff
Category/Department: Mexico
Published: 2009-07-15

There is nothing to dispute projections that Mexico's economy is going to contract in 2009, although there is uncertainty about how deep the GDP decline will go. The latest official forecast from President Felipe Calderon's administration is that Mexico's GDP will contract by 5.5% this year (SourceMex, May 20, 2009), but many private analysts and multilateral institutions believe that the decline will be deeper than that.

The latest international projection came from the Economic Commission for Latin America and the Caribbean (ECLAC), which anticipates a 7% contraction in GDP. In its report released in mid-July, ECLAC said the forecast of a 7% contraction in Mexico's GDP this year is the worst for Latin America. The organization projected a 1.9% contraction for the region as a whole, with other large economies also expected to remain sluggish this year. Argentina is projected to have a 1.5% GDP growth and Brazil a contraction of 0.8%. ECLAC's 2009 projections for Mexico are on par with recent forecasts from the International Monetary Fund (IMF), which in early July projected Mexico's GDP would contract by 7.3% this year.

The IMF's latest estimate for Mexico's GDP decline is twice as large as one forecast in an April report. The anticipated declines are larger than those based on the average of private economists who answered a Reuters news service survey in June. The survey, released in early July, showed that economists on average anticipated a 6.3% decline this year. Just a month earlier, the average of projections by economists was for a 5.5% contraction this year.

The IMF and ECLAC both reiterated that Mexico is feeling the brunt of the economic downturn because of its strong reliance on the US economy, not only for exports of manufactured goods and crude oil but also for remittances from expatriates and from the funds brought into the country by US tourists. There have been some comparisons with the 1995 economic crisis, which followed the devaluation of the peso. But analysts point out that the earlier crisis was caused entirely by internal factors, namely the overreliance on short-term indirect investments, along with low foreign reserves to back up these investments (SourceMex, January 04, 1995).

The analysts note that the current crisis is tied almost entirely to factors outside Mexico's control. "In the current situation, almost all the impact is coming from overseas," said analyst Rafael Carmona of Grupo Santander. "The manufacturing sector has been hit hard by the lack of imports from the US." Analysts noted that exports to the US market are a major driving force for the Mexican economy. Roughly 85% of Mexican exports went to the US market in 2008. And with US purchases of Mexican goods slowing down considerably during the US economic downturn, Mexican exports have plunged. "Mexico has a very weak internal demand," said analyst Manuel Galvan of the Mexico City-based economic research company Metanaysis. "So that is the main reason why we are

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seeing a deeper recession in Mexico than in the United States." A study by Grupo BBVA Bancomer said four manufacturing sectors in particular have been hurt by the US downturn: mechanical equipment, computers and electronics, machinery, and motor vehicles. The five sectors less affected by the US downturn are food, beverages and tobacco, paper, clothing and textiles, plastics and rubber, and chemicals and their derivatives.

Recovery anticipated in 2010

There is wide optimism that Mexico's economy will recover in 2010, mostly because of an anticipated rebound in the US economy. ECLAC has forecast a 2.5% GDP growth for Mexico next year, while the IMF is predicting an expansion of 3%. The IMF's forecast is identical to a recent prediction by Finance Secretary Agustin Carstens. "Once we touch bottom, we will have a vigorous economic growth of 3% in 2010," said the finance secretary. But Carstens said this trend is contingent on the behavior of the US economy. "In the same way that the US economic downturn brought Mexico's economy down, a recovery in the global economy, especially in the US, will help speed up a rebound in our country," he said to regional directors from BBVA Bancomer. Guillermo Ortiz, chief governor of the Banco de Mexico (central bank), also projected a 3% growth in Mexico in 2010 during a conference in Madrid earlier this year. "The speed of our recovery will depend heavily on what happens in the US economy," said Ortiz. "But when your downturn is deep, your recovery is also faster."

The GDP forecast will be a key component of the budget blueprint that the Calderon administration will present to the Chamber of Deputies in September. Unlike his first three years in office, Calderon will be facing a Congress dominated by the opposition, following the landslide victory by the Partido Revolucionario Institucional (PRI) in the July 5 elections (SourceMex, May 08, 2009).

A handful of PRI members who have been assigned to negotiate budget matters with the administration said they will push the Calderon government to cut administrative expenditures and channel more funds toward social programs. Some business organizations are also drafting budget and economic proposals to present to the PRI-dominated Congress during the coming year. The proposals will center on tax reforms, which would help the government expand its revenues. "We have to develop a single tax...without special treatment for any sector," Armando Paredes Arroyo, president of the Consejo Coordinador Empresarial (CCE), told reporters in a press conference. "This tax should be simple and easy to collect and to pay." The CCE president said the organization is not ready to recommend implementing a value-added tax (impuesto al valor agregado, IVA) on food and medicines, although it will look at the possibility. The business community generally supports imposing an IVA on basic foodstuffs. But such a tax would be politically unpopular, and Congress is unlikely to include it in any tax reform (SourceMex, August 25, 2004 and June 27, 2007).

Whatever shape the tax reform takes, said Paredes, it should be accompanied by a sharp reduction in government expenditures. "The government is bloated," said the CCE president, who suggested that the administration eliminate some departments as well as "irrelevant" expenditures. Paredes said changes in the tax structure could potentially boost Mexico's GDP growth by one percentage point beyond the 2% to 3% projections for 2010.

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